Acting for clients as they would want to act for themselves

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Backing the future

30 years of Killik & Co, **p4**

Head Office

46 Grosvenor Street,
Mayfair,
London W1K 3HN

Private Client Team
Simon Marsh, Fred Robinson,
Kristian Overend, Michael Pate,
Michael Berry, Gary Meredith
T: 020 7337 0400

Mayfair Team
Julian Spencer, Jeremy Sheldon
T: 020 7337 0714

Grosvenor Team
Fabrizio Argiolas
T: 020 7603 5203

Killik Asset Management
Graham Neale
T: 020 7337 0008

Family Office
Jer O'Mahony
T: 020 7337 0664

Locations

Chelsea
James Dunn
45 Cadogan Street,
London SW3 2QJ
T: 020 7337 0590
E: chelsea@killik.com

Chiswick
George Harrison
23 Chiswick High Road,
London W4 2ND
T: 020 8090 3303
E: chiswick@killik.com

Esher
Paul Martin
9 Esher High Street,
Surrey KT10 9RL
T: 01372 464877
E: esher@killik.com

Hampstead
Peter Day
2a Downshire Hill,
London NW3 1NR
T: 020 7794 3006
E: hampstead@killik.com

House of Killik Northcote Road
Richard Morris
125 Northcote Road,
Battersea SW11 6PS
T: 0207 337 0455
E: northcoteroad@killik.com

Richmond
Ian King
2 Paradise Road,
Surrey TW9 1SE
T: 020 8948 7337
E: richmond@killik.com

Wealth Planning
Svenja Keller
46 Grosvenor Street,
London W1K 3HN
T: 020 7337 0724
E: svenja.keller@killik.com

City
Nicholas Crellin
20 King Street,
London EC2V 8EG
T: 020 7600 9990
E: city@killik.com

Kensington
Julian Chester
281 Kensington High Street,
London W8 6NA
T: 020 7603 3618
E: kensington@killik.com

Choosing the right language

Tim Bennett

Head of Education

"Are you free to explain how the equivalence regime currently works, who is included, who isn't and who might lose out?". A few hours after that request landed from the BBC, I was being filmed in our Grosvenor Street office for a London Evening News slot. The research that preceded my appearance left me wondering, not for the first time, quite how officials in Brussels could have come up with such a grandiose and baffling term.

Equivalence describes something important – the proposed future relationship (at the time of writing) of the City with the EU's financial markets and customers under the Theresa May Brexit deal. Anyone who missed my explainer on the BBC can catch up by watching my short video at killik.com/Explains/Brexit. As with so many of the phrases favoured by bureaucrats the world over, I had to start by discussing what many might assume it should (but in fact does not) mean. For example, "equivalence" is not "equality", because the resulting arrangement cedes more control to Brussels than London. Nor does it describe an arrangement that automatically mirrors (i.e. would be "equivalent to") the sort the EU has struck with non-EU countries, such as the US, Canada and Japan. Instead, it refers to an arrangement whereby the EU retains a veto over City access to its markets, should our rules not remain equivalent to theirs. Not obvious, is it?

The EU isn't alone in this of course. The financial services industry globally lost a lot of trust in the wake of the financial crisis over a decade ago thanks, in no small part, to an inability to communicate concisely with its customers. This is odd, given that City firms employ many bright, and supposedly articulate, people. I suspect that part of the explanation is fear – the worry that by opening the "black box" and telling people how their money is being invested, the mystique will be lost. Or, it could be that after years of working with peers steeped in finance industry jargon, City people simply lose the ability and the will to communicate normally. Perhaps that is why financial copy and headline writers at the tabloids are paid more than their peers working for the broadsheets – striking the correct balance, as they usually do, between simplifying (good) and patronising (bad) is becoming a lost art.

Thank goodness then that, 30 years after Killik & Co was founded in 1989, Paul Killik remains as determined as ever to break down the communication barriers in investment management and wealth planning and open the financial world to everyone. My job is proof of his commitment. I am in good company these days – Martin Lewis at MoneySavingExpert and Holly Mackay at Boring Money are also toiling away to bust jargon and persuade those who work in finance to keep things simple. If I have one piece of advice for investors in 2019, it would therefore be this – when in doubt, challenge the language. If someone can explain something to you in a clear, succinct manner, you are probably talking to the right person. And if they can't, be wary.

COMING UP

SECURITIES IN THIS ISSUE

30 years young

Paul Killik
Senior Partner

Georgie Killik
Head of Innovation

Killik & Co first opened its doors in 1989, in what was an old pharmacy in Chelsea. As the firm enters its fourth decade, Paul and Georgie Killik reflect on how far it has evolved and discuss what lies ahead.

What were your key aims when the firm was founded?

Paul – We've always taken a different approach to most of the businesses in our peer group. Much of what I wanted to achieve with the firm in its earliest years grew from my experience of the Thatcher era in the 1980s. She believed that our entrepreneurial country needed to have capitalism embedded into its collective psyche. A big part of achieving that was encouraging people to take more control over their financial futures by coming to the stock market.

That mindset chimed with my view at that time (and one I still hold today) that saving needed to be less institutionalised. I have also always had a passion for getting people onto the savings ladder no matter what their level of wealth. So, I wanted to create a firm that was open to ordinary investors and that offered a physical presence in the local community.

I have also always believed in the power of financial education as a way of breaking down the barriers between our industry and its customers by conveying key investing principles, such as the power of compounding. I still worry that people are not doing enough for themselves when it comes to long-term saving. Some of that is down to a lack of knowledge, which in turn generates fear and distrust. With the government backing away from retirees, for example, whether by raising the State pension age or cutting back on care provision, many people with very low levels of savings are in for a future shock. We need to find ways to persuade them to lift their heads out of the sand and make sure that they grasp the benefits of long-term investing, regardless of their wealth.

How is a reputation for innovation being reflected now?

Georgie – Technology has presented us with a fantastic opportunity to go back to our roots in the broad savings market. 30 years ago, the firm did it by getting out onto the pavement and opening the first branch of many in Chelsea. Whilst these physical locations are still a vital part of our business, our new Silo app will allow us to offer the widest possible audience effortless access to long-term saving and investing.

What separates us from many of our Fintech rivals can be captured in one word – choice. We will never push people towards either a human advisor, or a fully automated solution. Rather, our aim is to blend 30 years of investing heritage and expertise with the best that current technology can offer, to give people the maximum flexibility about how and when they save. That way we will continue to serve the needs of people who actively want advice straight away, alongside those who don't initially but who need an easy way to start saving. We have been careful to balance design and function when it comes to our app – we want to give people a high quality and consistent user experience, however they choose to engage with us.

What is the secret of building long-term client loyalty?

Paul – One thing we have always prided ourselves on is the stability of our employee base: once people join the firm, they tend to stay. This is vitally important when it comes to maintaining a consistent level of client satisfaction and nurturing long-term relationships of trust. Many clients also value the fact that we not only offer expertise in investment management and wealth planning, but we can also cater for anyone seeking important related services in areas such as currencies, estate planning and tax. I have also always sought to remove the feeling of intimidation that people sometimes feel around financial services and any hint that investment advisers can hide behind a "black box" – we aim to be open and accessible no matter what someone's age, background, status or financial situation.

How is that client focus evolving today?

Georgie – Firstly, we will always try to ensure that clients can engage with us on their terms, whether that is via a phone call, a face-to-face meeting, through our online portal, or by using the app. ▸▸

Secondly, we are focused, more than ever, on trying to ensure that we talk to families and not just individuals in isolation. As a society, we face a potential double-whammy of rising life expectancy, alongside the loss of many of the things people used to take for granted as financial backstops, whether State care in old age, final salary pensions in retirement, rising house prices, or even paid-for university tuition. Therefore, it is more important than ever that different generations within a family talk to, and support, each other, emotionally and financially. We will continue to see our role as being a trusted advisor to every generation within a family.

Is intergenerational planning more important than ever?

Paul – Rising longevity, as average levels of health improve, alongside a sea-change in the pensions landscape, are combining to change the way families should plan. In 2019, it is perfectly possible to see four generations of the same family alive at the same time, which is clearly wonderful. Meanwhile, with better health comes the opportunity to work on longer and well past a traditional retirement date. This not only reduces the amount people are spending in retirement but even opens the possibility that the value of their estate will continue to rise, rather than fall, as they postpone drawing down on it.

I think many in my "baby boomer" peer group are aware of how fortunate we have been to enjoy rising house prices, generous pensions and an expanding welfare state. I do therefore think that older generations should feel willing and able to support younger ones, who are simply not going to benefit from the same tailwinds. They may harbour hopes and aspirations similar to their parents before them, but the reality is they are going to need support in order to achieve them.

The good news is there is plenty that can be done. Just to give one example, a subscription of £4,260 into a Junior ISA on behalf of a great-grandchild, followed up by a similar amount every year for the next six, would leave them with a pot worth around £787,000 aged 70 and over £1.2m by the age of 80, were the funds to achieve an average real growth rate of 5%. Clearly 5% is not guaranteed, tax treatments depend on personal circumstances, and your capital can be at risk in equities, but over a sufficiently long period compounding can nonetheless be pretty powerful.

How are younger people thinking about retirement?

Georgie – I don't think that they are, in any conventional sense, any more. There is a growing acceptance that most people will work on until much later than their parents perhaps did, health and opportunity allowing of course. The way we work is changing, which is giving people new opportunities, whether flexible working or trying something new altogether. What worries me is the number of people I meet for whom this is their only long-term plan, which rather smacks of putting all your eggs into one basket. Whilst there are many reasons why people may want to carry on working, I think everyone needs a separate safety net in case they can't, or no longer want to, when the time comes.

Although saving for retirement can seem daunting, young people have one huge ally – time. Over sufficiently long periods, even small amounts add up – £150 per month, for example, invested at 5% per year over 50 years, could be worth around £387,000 (before charges). And bear in mind that if you are saving through a pension, a chunk of that £150 contribution may come in the form of either an employer's contribution, tax relief or both.

What has frustrated you the most over your career?

Paul – Since the firm was founded I have always pushed back against those who have sought to take responsibility and ownership away from individuals. This is something the EU seems obsessed with thanks to a one-size-fits-all approach to regulation that I believe to be ill-suited to the UK. Over the last 20 years, I have fought hard for the democratisation of bond ownership and against the idea that funds offer a better route for investors than diversified portfolios of carefully selected individual securities.

When it comes to equity investing specifically, I think it is vital that people are able to buy the companies that they like and admire, rather than being limited to a unitised solution over which they have little control and for which they may have little real enthusiasm. I am hopeful that technology can help here – as people gain in confidence, they will naturally want to move away from simple, passive solutions and onto direct share ownership, something I think apps will increasingly be able to facilitate.

Meanwhile, although the seemingly constant tinkering that we see with the tax rules is frustrating, the existence of tax-effective savings wrappers for adults and children alike has undoubtedly been hugely helpful in encouraging people to invest. Whilst no-one should ever try to second guess governments, I hope that the fundamental principle that lies behind today's ISAs and SIPPs (TESSAs and PEPs when the business first started) will never be lost, or diluted, by the Treasury.

What most excites you about the investing landscape now?

Georgie – For me, it's the rise of technology. That has been terribly important in helping people to take that vital first step onto the savings ladder. Many younger savers, in particular, may not have the confidence to pick up the phone, or engage with an ▶▶

adviser. Technology offers them the chance to start somewhere and build vital knowledge and confidence for when their lives become more complicated and they decide they need more than an app. Education is a key part of this – the more people know about why, and how, their money is being invested, the more they will want to learn and invest – it's a virtuous circle.

What does a life well-lived mean to you?

Paul – Over a long working career (50 years and counting!) I have been able to provide an increasing amount for my family, whilst thoroughly enjoying my life inside and outside work. I have been lucky in that I still love what I do as much as when I first started.

Since I don't much enjoy gardening, I haven't played golf for a very long time and can already travel, I feel no need to retire while I am enjoying my work and still helping to build this business. So, for me, a passion for what you do (which includes meeting a social need by helping to remove the intimidation of finance), plus the ability to secure your family's future, are the key ingredients of a good life.

Do younger generations feel the same?

Georgie – Hard work and the financial security it can bring are certainly important over the longer term. However, I think nowadays people prioritise experiences too. There have never been so many ways to explore and enjoy the world, on almost any budget, as there are today. People therefore want to create as many memories as possible. Whilst social media has its critics, it does allow people to capture shared moments and look back on them more easily than ever before.

Our role is to help people to balance that desire to live a full life today whilst making sure that they are helping their future selves at the same time. The two don't have to compete – once people grasp the power of compounding and the potential impact of saving early, little and often, they quickly see that their future security and well-being doesn't have to be sacrificed to achieve today's goals.

What advice do you have for investors in 2019?

Paul – Firstly, people need to understand that equity investing is for the long-term. The longer you've been around, the more bull and bear cycles you will have seen. You realise that short-termists and market timers are doomed to fail in the vast majority of cases.

Next, investors must not be too parochial. We live in a global age where pockets of entrepreneurship exist all over the world. Fortunately, we can now invest globally much more easily than in the past – I think that's very important.

My third "no-no" is sticking with yesterday's ideas. Technology is disrupting sectors like never before and investors need to be alert to that and position their portfolios to buy tomorrow's winners, not yesterday's laggards. I firmly believe that you can date a portfolio just by looking at its constituents – all too often we are asked to take over accounts that look to have been opened during the Stone Age!

It is also my firm belief that investors must avoid simply following the herd, in the mistaken belief that the herd knows where it is going. Too often investors, who have not been advised, will panic-sell out of a bear market, for fear of greater losses, with no strategy about when to re-enter; or they will succumb to greed and chase a bull market higher for fear of missing out. This is where advice can be critical as it helps to remove the emotion from what should be rational market judgements.

What would you say to a new saver?

Georgie – I want people to stop thinking "I don't have enough to get started, so I won't". I also want to encourage people to take more control and ditch the old-fashioned tendency to leave the responsibility for family finances to parents, a spouse or their partner. If we can educate more people to start saving and get them to take more control over their financial futures, I will be very happy. ●

Killik Explains

Novice and more seasoned investors alike may like to speak to an Adviser about our series of free short educational guides. These concise, jargon-free booklets cover; how to invest in equities, how to save and invest tax-efficiently, how to save and invest for your family, how to build a retirement fund and how to generate an income in retirement.

Bridging communities

Clotilde Robin

Project Engineer

With support from the Killik & Co Charitable Trust, Clotilde Robin set off to Rwanda just before Christmas to help with a vital bridge-building project. Tim Bennett caught up with her at House of Killik, Northcote Road.

How did you get into engineering?

I started working as an engineer around twelve years ago in Paris. As a French graduate, you specialise in civil, mechanical, or chemical engineering. Civil always appealed to me because I have a personal passion for architecture. Fortunately, I found universities in France and then Berkeley, California that would let me study both at the same time before I started working for engineering giant Arup. During my time there I focused initially on the design and engineering of commercial buildings such as skyscrapers. Then I discovered my true vocation.

Why bridges?

I was hooked from the moment I completed my first one – a footbridge in Dunkirk that we took from the design calculations stage through to construction. The work finished just after I moved to London five years ago and I knew then that my heart was set on bridges. I joined COWI, who have allowed me to follow my professional passion ever since.

I like bridges for their engineering purity – they demand very precise calculations but ultimately they are simple structures. I also love the idea of linking two places, or communities. When you first see a bridge, it's instantly recognisable, and I think most design engineers would admit that's part of the attraction too. Then there's the fact that a properly built example should last 100 years and make a long-term contribution to society.

What is the hardest type to build?

In pure engineering terms, the longer the span, the harder the design and build. There has, for example, been talk for years about whether a bridge could be used to cross the English Channel, or the Strait of Messina. Both would be hugely exciting, but also very complex, projects that would take engineering to its limits.

However, small ones can also be technically challenging too. Many have complicated architecture, even if they are less of an engineering feat. For me, they are just as satisfying.

My ideal project lies somewhere in between – an urban bridge of up to about 100 metres in length presents a lot of choice about how it is designed along with plenty of stimulating challenges when it comes to its construction and local integration.

Do you have a favourite?

The Salginatobel Bridge in Switzerland, built by Robert Maillart. Using the right amount of material in precisely the right way, he created a structure that is effective and beautiful at the same time.

How did you become involved in Rwanda?

My current company has been in a partnership with a charity called Bridges to Prosperity for the last five years. They specialise in providing bridges for rural communities in under-developed countries. In Rwanda, they work with the government, which is vital to reducing the risk of building something that could subsequently be damaged, or even destroyed. Villages apply through the government, and they then work with the charity to choose and prioritise the site. Meanwhile, universities are involved to monitor and measure the number of people each bridge helps, whether that is getting children to school, or farmers to market.

Where is your bridge?

The one I helped with is near Lake Kivu. In dry season, the problem area is just a small river, which the locals can cross on foot. In rainy season, however, the water level rises fast and the same river becomes dangerous and fast-flowing. The new bridge will help people with the day-to-day tasks of getting to school, the local market, or the doctor. The charity has connected over a million people worldwide through projects like this one.

I was there as an engineer to oversee the construction process and advise as it progressed. The building work was carried out by locals, who could be quickly trained in the basics, such as pouring concrete. A few were then selected to help with the subsequent inspection and maintenance. Education is important too – we tried to ensure, with the help of the village chiefs, that the locals feel that they now own the bridge and understand its importance.

Who pays for these projects?

The basic construction cost, including materials and labour, is paid for by the various sponsoring companies. I am then one of 10 people who went out to oversee the construction. We raised money separately to cover our own transport, plus equipment – everything from spanners, saws and drills to gloves and safety glasses. We donated it all to the charity for future projects before we left. I am very grateful to Killik & Co for the help we received here.

How will you measure success?

First and foremost, via increased footfall – lots of information will be gathered about who is using the bridge, how often and why. Just as important to me, however, were the looks of happiness and gratitude on the faces of the villagers we helped.

The only constant is change

Patrick Gordon

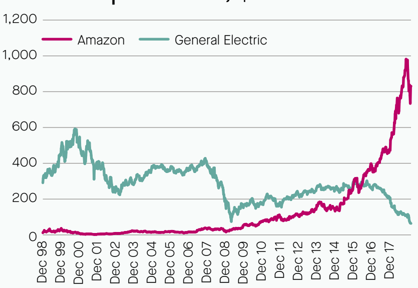
Head of Research

As Paul Killik notes on page 4, much has changed since he set up the firm in 1989. This quarter I look at two forces that have reshaped the way investors look at the world – the impact of disruption on the US stock market over the past decade and the growing long-term global influence of China.

Keeping a seat at the top table

History has shown that investing in the leading companies of the day can yield strong investment returns, particularly if those firms continue to grow, whilst defending their market positions and prudently managing their financial risk exposures. However, selecting winners isn't easy because today's victors will not necessarily stay on top; as some companies grow, so others fade.

Chart 1 – Amazon and General Electric; Market Capitalisation, $bn



Source: Bloomberg

Changes in the constituents of market capitalisation-based indices bear testament to this. For example, two of the biggest companies in the world today, Apple and Amazon, did not make the S&P 500's top 10 a decade ago. Meanwhile, General Electric, which for decades featured amongst the largest 10 companies in the US, only just makes it into the top 100 firms at the time of writing, following a steady decline in its share price (**chart 1**). In June 2018, the firm suffered the ignominy of being dropped from the Dow Jones Industrial Average, having been an original constituent of that blue-chip index when it was established in 1896 and a continuous member from 1907.

Whilst some companies may disappear from an index as the result of a corporate action, such as an acquisition or merger, history is also littered with examples of companies that simply failed to adapt to changes in their operating environment, or that were torpedoed by poor management decisions. Amongst many examples of this are overextending the balance sheet and failing to invest adequately for the future.

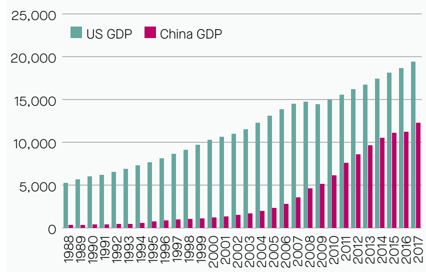
Anyone remember Eastman Kodak? A once dominant force in photography, the firm filed for bankruptcy in 2012, later to emerge restructured as a different, and much smaller, entity. The brand had lost out in the move to digital, as new entrants disrupted its traditional market. Today, almost every smartphone has a camera capable of producing photographs, or video images, that vary between acceptable and exceptional quality. The lesson for investors in 2019 is that in a rapidly changing world it is important not only to spot today's winners, but those firms that will still be dominant in another decade. As part of that process, it is vital to identify how disruption will affect a business model, for better or for worse.

The importance of correctly reading potential changes in the investment landscape also extends beyond specific companies, or sectors. Although many of the best companies of the future will be based in Western markets, as Paul notes on page 5, growth orientated investors who fail to look beyond their domestic market, or even developed markets more broadly, may miss out. Some of the most exciting global investment opportunities can be found in emerging markets, or through companies with exposure to them. And none more so than the largest market of them all, China.

Eastern promise

China's economic expansion since the turn of the millennium has seen its gross domestic product (GDP, in current US dollars) rise spectacularly (**chart 2**). It is now the second largest economy in the world, and the gap between it and the United States, the incumbent leader, looks set to continue to narrow.

Chart 2 – World Bank – US, China GDP in Current USD, bn



Source: Bloomberg

Whilst China's economic emergence has been impressive, such rapid expansion has also arguably led to imbalances within the economy. The debt-fuelled nature of much of this recent growth, and a significant focus on investment, has created pockets of capital misallocation and over-capacity. As the authorities have sought to rein in some of these excesses, growth has slowed.

Yet, even a slowdown from current levels will, in all likelihood, still see China's economy grow faster than most developed market economies. The consensus forecast from Bloomberg points to real GDP rising 6.2% in 2019 and 6.0% in 2020. Whilst the future rate of growth may be slower than in the recent past, we believe that it is also likely to be more sustainable, as Beijing attempts to pivot this vast economy more towards domestic demand.

With a population estimated at almost 1.4 billion, China is the world's most populous nation, accounting for about 18.5% of the total number of people on Earth. This represents an enormous

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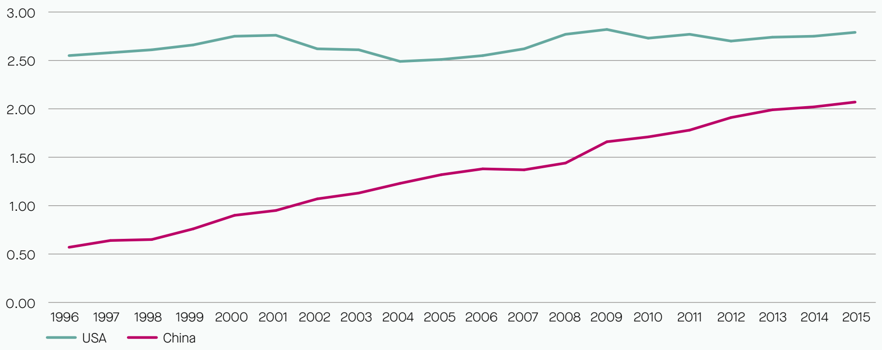
Chart 3 – World Bank – R&D Expenditure, % GDP



Source: Bloomberg

domestic market, offering huge consumption growth potential, particularly from the enhanced spending power of an expanding middle class.

It is not just China that offers the scope for a large increase in domestic consumption - other emerging (albeit risky) economies, such as India and other leading Asian countries are also part of this story. According to a paper published by the Brookings Institution[1], almost 90% of the next billion people in the global middle class are expected to be situated in Asia. By 2030, the region could represent two-thirds of this demographic globally, as expected growth far outweighs that in the more mature markets of the US, Eurozone and Japan.

"New economy", new opportunities

The attraction of China as an investment destination extends far beyond this one factor, however; China appears intent on taking the world lead in a number of "new economy" areas. This is evidenced by the fact that, over the years, it has significantly increased its research and development (R&D) expenditure. Data from the World Bank shows that in 2015, China spent about 2.1% of GDP on R&D, compared to just over 0.5% in 1996. This is still some way below that of the US, but the gap has nonetheless been closing (**chart 3**).

Furthermore, according to an annual report by the World Intellectual Property Organization[2], of the 3.17 million patent applications filed in 2017, China's State Intellectual Property Office received a record total of 1.38 million filings. That equated to 43.6% of all applications filed and more than double the number received by the United States Patent and Trademark Office. The same report shows that 65.1% of patent applications in 2017 were in offices located in Asia, compared to 49.7% 10 years ago, with growth being driven mainly by filings in China.

This is important, because the competitive cost advantage that China offered as the 'workshop of the world' during the earlier stages of its recent economic development continues to be gradually eroded. As wages have risen in labour-intensive industries, China has sought to increase its competitiveness in technology-based areas. The 'Made in China 2025' modernisation plan, which has the support of the government, aims to boost the domestic content within products and lessen China's reliance on foreign companies. Its ambition is no less than ensuring that China becomes globally competitive in key disruptive areas that include robotics and 'new energy' vehicles. Beijing is also seeking to make China a leader in artificial intelligence (AI) by 2030.

Looking ahead

None of this has gone unnoticed in Washington. Concerns that US companies will find it more difficult to compete in areas where Chinese companies are receiving large state investment and subsidies, are arguably amongst the factors contributing to the current trade war between the US and China. At the time of writing, this appears to be some way from being resolved and is likely to overshadow markets, to some degree, in 2019.

For investors seeking to benefit from longer-term equity growth opportunities, a recognition of the landscape-shaping power of factors such as technological advances, or demographic and economic shifts, will remain important. Over time these will continue to influence portfolios, as tomorrow's winners oust those firms that are unable to cope when disruption upsets the status quo.

[1] *The Unprecedented Expansion of the Global Middle Class: an update, Brookings Institution, February 2017*

[2] *WIPO (2018). World Intellectual Property Indicators 2018*

Killik & Co Security Risk Ratings

All research recommendations are issued with a security specific risk rating, represented by a number between 1 and 9. Assessing the relative risk of any security (specific risk) is highly subjective and may change over time. The Killik & Co Risk Rating system uses categories which are intended as guidelines to the specific risks involved, as follows:

1. Restricted Lower Risk

Securities in this category are what we believe to be lower risk investments such as cash, cash equivalents and short dated gilts, and the collective investment vehicles that invest in those instruments.

2-3. Restricted Medium Risk

Securities in this category are what we believe to be medium and lower risk investments including medium and long-dated gilts, investment grade bonds and certain collective investment vehicles investing predominantly in these securities.

4-9. Unrestricted

Securities in this category are what we believe to be higher risk and are drawn from across the United Kingdom and international markets. These are normally direct equity investment and collective investment vehicles which predominantly hold securities other than investment grade bonds and money market instruments.

The vast majority of the Killik & Co Research recommendations are likely to fall in the unrestricted/higher risk category (4-9) above.

For further details on the Killik & Co Risk Rating system please see the Killik & Co terms and conditions.

Looking long-range

Andrew Duncan

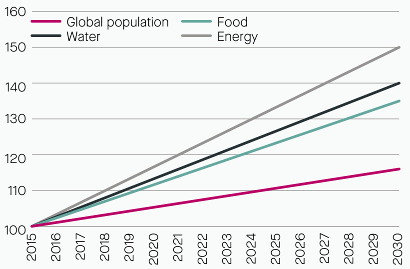
Senior Equity Analyst

As Killik & Co celebrates three decades of independent investment thinking, we look ahead and offer a snapshot on three themes that we think should inform your investment approach along with some of the stocks that currently offer a way of accessing them.

Protecting the planet

We believe the health of the environment will become an increasingly important theme over the coming years. Key drivers will include; increasing regulation, resource scarcity, pollution and extreme weather. Meanwhile, a rapidly growing global population is set to reach 9.6 billion people by 2050 from 7.7 billion today. As a result, by 2030, it is estimated that the world will need 40% more water, 35% more food, and will be using 30% more energy (**see chart**). Essentially, the world will need to do a lot more with less.

Impact of global population growth on demand



UN, Ecolab

Within that remit, we see an important role for companies that support the $600bn global water market by, for example, creating critical infrastructure such as pumps and water treatment facilities. Xylem (XYL-USA) is arguably the leader in solving global water problems and the purest play on this theme in our investment universe.

We also like companies that indirectly improve the environment, through innovation in equipment and chemicals. Nidec (6594-TKS) is a Japanese firm with a leading position in electric motors, which account for roughly half of all electricity consumed each year. By making more efficient motors, across diverse industries such as home appliances and automobiles, this company can help to slow the growth in global energy demand.

Similarly, on the chemical side, Ecolab (ECL-USA) employs innovative techniques to allow its customers, across many industries, to reduce energy and water consumption. This reduces a firm's costs as well as its environmental footprint.

Harnessing industrial disruption

As we noted in the previous issue of Confidant, the fourth industrial revolution, also known as Industry 4.0, is a name given to the next generation of industrial automation. It presages a world where computers and machines communicate with each other to make smart factories a reality. This sweeping change encompasses a variety of technologies and platforms. These include; automation systems that can move and manipulate physical assets, the "Internet

Killik Explains

Every week, our Head of Education, Tim Bennett, produces a video on a topic that is relevant to novice investors, or those with more experience seeking a refresher. To watch videos on equity markets topics ranging from how the stock exchange works to safety checks for income investors, please go to *killik.com/learn* and click the "Shares" tab.

of Things" for performance measurement, cloud computing to process performance data, cognitive computing to enhance the resultant decision-making, and consulting services to facilitate integration.

These advances are all part of the digital transformation taking place across multiple industries. It will enable businesses to serve customers better whilst cutting costs and allowing them to respond to the threat of competitive disruption from new entrants. We see multiple beneficiaries from this secular growth theme, albeit in some key areas we believe it will take a while for clear winners to emerge:

- Automation players – although some aspects of global manufacturing are already highly automated (such as in the global car industry) there are still high growth opportunities in areas such as warehouse automation and the deployment of collaborative robots (or "cobots" - smaller robots that can work safely alongside humans). In this field, Teradyne (TER-USA) has a strong position, with over 50% market share and market-leading technology
- Cloud providers – these entities will facilitate the connection of billions of new devices and the harvesting of large amounts of data. They will also provide the cognitive computing capabilities that will allow meaningful decisions to be taken automatically from these vast data sets
- Semiconductor makers – not only will cloud providers drive the need for a large amount of computing resource but we also anticipate demand for significant semiconductor content (processing and memory) across many connected and smart devices
- Software providers – many major providers are critical to the creation and distribution of the software needed to make this digital transformation possible

Lengthening lives

The long-term drivers that underpin our position on the global healthcare industry remain very much in place. Rising life expectancy and an ageing global demographic continue to provide long-term support, whilst the relative economic insensitivity of the industry provides a useful diversifier within portfolios at this point in the cycle. However, as we highlighted last year, it is also clear that there are some major structural changes taking place. The widely accepted view, that the growth in government spending on healthcare is unsustainable, is providing a catalyst for the drive to improve the efficiency of healthcare systems around the world. These need to be able to deliver better healthcare, to more people, for less money.

The widely accepted view, that the growth in government spending on healthcare is unsustainable, is providing a catalyst for the drive to improve the efficiency of healthcare systems around the world.

As part of this, the industry has seen a move towards recognising and rewarding the value delivered by each therapy. The resulting outcomes-based (rather than volume-based) pricing model creates a number of opportunities, but also some notable threats, within the sector. On the one hand, the largest incumbent pharmaceutical companies may face significant and permanent adverse changes in their core businesses. Meanwhile, other beneficiaries will spring up over time from unexpected, data-driven and technology-enabled parts of the industry.

Further disruption is emanating from key developments in healthcare innovation that enable practitioners to take a more personalised approach to the delivery of care. For example, significant advances in gene sequencing have enabled the so-called 'third wave' of treatments that use cell and gene therapies to address disease, rather than drugs or surgery. After several decades of evolution, this area of research looks set to have a transformational impact on the industry. With the first gene therapies recently approved in the US, a growing sector has demonstrated that it is ready to start delivering solutions to patients.

For investors, Thermo Fisher Scientific (TMO-USA) is a key player "serving science" and stands to benefit from a number of leading themes spanning global healthcare. These include; increased research and development (R&D) spending by drug companies and academia, growth in R&D in emerging markets, and a trend to outsourcing production and supply chains within large pharmaceutical and biotech companies. The firm has become more defensive over the last few years as a result of serving fewer cyclical end markets. Around 75% of revenues now come from recurring sources (consumables and services), with 25% coming from equipment and machines, a market in which it has a leading position.

Key data

Name	Market cap	P/E ratio	Yield (%)	Price	Currency	Risk rating
Xylem	12bn	20.6	1.3	67	USD	7
Nidec	3.7trn	23.0	0.9	12,475	JPY	7
Ecolab	43bn	25.9	1.1	147	USD	6
Teradyne	6bn	13.3	1.3	31	USD	7
Thermo Fisher Scientific	90bn	18.8	0.3	224	USD	6

As at 2nd January 2019.
For more information about the Killik & Co Risk Rating system, please refer to page 9.
Please speak to your Investment Manager for further information.

Opening up the world of closed-ended funds

Gordon Smith

Senior Fund Analyst

This quarter I would like to reflect on the astonishing growth that has taken place across the fund universe over recent years and shine a spotlight on some of our preferred closed-ended vehicles.

Spoilt for choice

Investors enter 2019 facing the biggest array of retail funds in history. The growth in money under management within the vast open-ended fund universe has continued unbounded. Data from the Investment Association (IA), the trade body that represents UK investment managers, shows that assets under management for those funds represented by the association, have grown from under £400bn in 2008 to over £1,200bn in 2018.

Alongside this, we have seen dramatic growth in the Exchange Traded Product (ETP) sector over the last decade. There are now well over 1,100 exchange traded funds (ETFs) and nearly 500 exchange traded commodities (ETCs) listed on the London Stock Exchange (**chart 1**). Between them they accounted for over £100bn of trading over the last 12 months. With 33 separate issuers of ETPs operating in the London market, there have been huge advances in product innovation – investors are now able to select from a broad range of passive investment strategies. Rather than sticking to more traditional market capitalisation weighted indices, today's passive funds can target specific investment themes, sectors, geographies and investment factors.

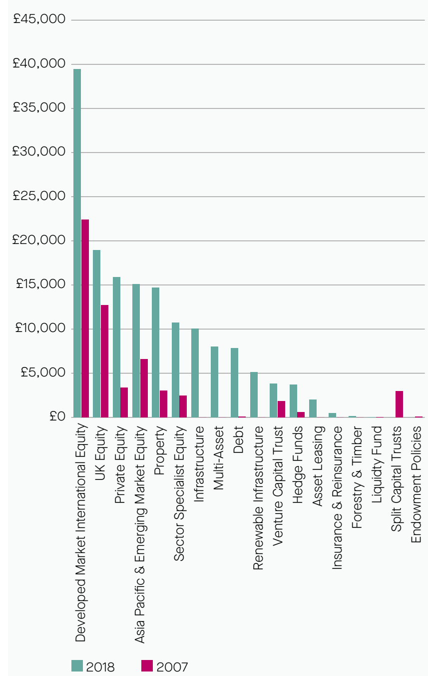
Last, but not least, we have seen a significant evolution of the listed closed-end fund universe. The Association of Investment Companies (AIC), the trade body for closed-ended investment vehicles, provides some useful statistics for this, perhaps less well-known, sector over the last decade. The number of

offerings has grown from 334 to 445, with new launches, additional capital raises and market growth driving the total market capitalisation of the sector from around £56bn to £156bn. Beneath these headline numbers, we have also seen some interesting changes in terms of where inflows have been going.

Behind closed doors

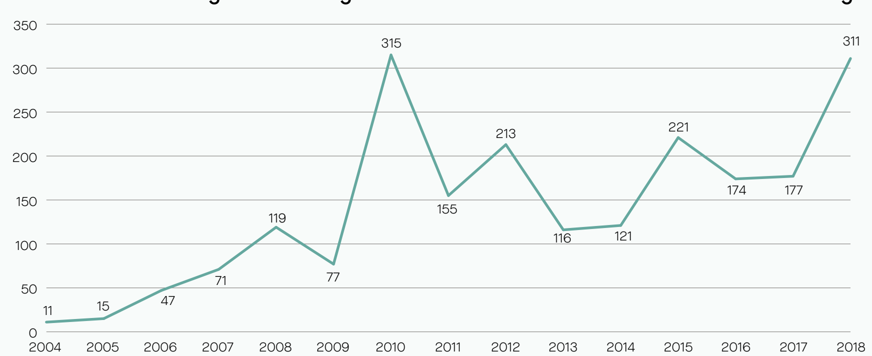
Chart two shows how dramatically the size of some of the major investment categories has changed since 2007. Equity strategies continue to dominate, albeit the growth in the number of offerings within the developed market sectors has been only modest, with most of the newer launches focused on the Emerging Market regions. The highest growth areas over the last decade have been the less traditional investment areas, most notably infrastructure, property, private equity and specialist debt strategies.

Chart 2 – LSE Listed Investment Companies – Market Capitalisation by Investment Category (£'m)



Source: AIC

Chart 1 – New listings of Exchange Traded Products on the London Stock Exchange



Source: LSE

There are several reasons why a closed-ended structure can work well in these instances. Firstly, there is the fact that these vehicles have a fixed capital base. Unlike their open-ended peers, this means that they are largely unaffected by investor in and outflows. That is particularly important where a manager wants to invest in less liquid assets, such as private equity and infrastructure. On top of that, a closed-ended structure facilitates borrowing more easily, giving a manager the ability to deploy structural gearing and aim to enhance returns from the more stable, often income-focused, investment strategies.

The launch of the UK Real Estate Investment Trust (REIT) regime in 2007 enhanced the sector further by facilitating property company conversions and new launches. Subsequent improvements to the REIT regime from 2012 boosted the attractiveness of this type of vehicle and have been a catalyst for further growth. In recent years, REITs have evolved to include a greater number of funds that target specific areas of the UK market, including the student property, residential, retail and logistics sub-sectors.

Under the microscope

Our fund research spans the entire range of fund structures. However, for exposure to illiquid assets and less mature markets, we have a strong preference for the closed-ended structure. That's because it allows a manager to take a long-term view, and harness any illiquidity premium on offer, without having to worry about managing redemption requests and daily subscriptions. Detailed screening reveals those investment companies that show strong, independent governance plus a willingness and ability to address discounts (to net asset value) should they arise. We also look for a low fee and expenses burden and a management team well aligned with shareholders. The four funds opposite meet these criteria. To discuss them in more detail, please contact your Investment Manager.

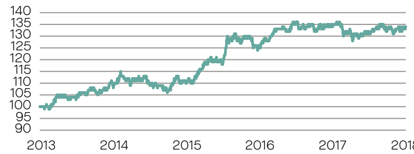
Key fund data and charts

Each quarter we look at the funds that we feel should be cornerstones in a portfolio, subject to your aims and objectives. Here are four core closed-ended holdings for 2019: to discuss any of these in more detail please contact your Investment Manager.

Growth	
Personal Assets Trust (PNL-LON)	
Fund Type	UK Investment Trust
Manager	Sebastian Lyon
Market Capitalisation	£922m
KID Impact on Return	0.83%
Historic Yield	1.4%

This London-listed investment trust aims to both protect the value of shareholders' funds over the long-term, as well as increase it. The trust invests in equities, bonds, cash and cash equivalents (including gold). Managed by Sebastian Lyon of Troy Asset Management, the investment process evaluates the relative attractiveness of different asset classes based on valuations and quality. The portfolio's wide diversification and defensive style are appealing at this stage in the market cycle. **Risk Rating: 4**

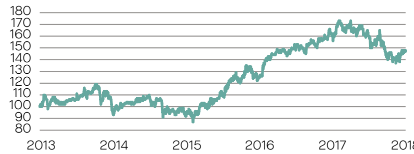
NAV Total Return
(last five years, indexed)



Income & Growth	
BlackRock Frontiers (BRFI-LON)	
Fund Type	Close-ended Investment Co
Manager	S Vecht, E Fletcher
Market Capitalisation	£288m
KID Impact on Return	2.54%
Historic Yield	4.2%

This listed investment company targets long-term capital growth from a portfolio of companies in less developed markets. The managers employ both top-down analysis of sectors and countries and bottom-up analysis of stocks, seeking opportunities from mispriced value or growth. Frontier markets offer a favourable environment for long-term investors, with typically faster GDP growth, younger populations and lower valuations than their more developed peers. **Risk Rating: 7**

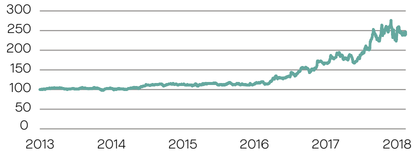
Total Return
(last five years, indexed)



Growth	
Syncona Ltd (SYNC-LON)	
Fund Type	Close-ended Investment Co
Manager	M Murphy and team
Market Capitalisation	£1.7bn
KID Impact on Return	2.18%
Historic Yield	3.5%

This listed investment company aims to achieve long-term superior capital growth from a mixed portfolio of life sciences investments alongside long-only and alternative investment funds. The aim, over time, is for it to become predominantly a life science investment company. Syncona and its unique capital structure offer an attractive method of accessing the 'Third Wave' of treatments using cell and gene therapies. These are now becoming commercially viable following decades of development. **Risk Rating: 6**

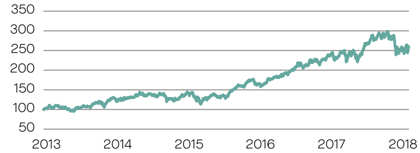
NAV Total Return
(last five years, indexed)



Growth	
Scottish Mortgage (SMT-LON)	
Fund Type	UK Investment Trust
Manager	J Anderson, T Slater
Fund Size	£7.1bn
KID Impact on Return	0.81%
Historic Yield	0.6%

This London-listed investment trust aims to outperform the FTSE All-World Index over rolling five year periods, investing in a high-conviction portfolio of global equities, with up to 25% invested in private companies. The managers look for strong, well-run businesses. The portfolio is also weighted towards companies which have disrupted their respective industries. Many also benefit from structural tailwinds, such as advancing technology, or changing market dynamics. **Risk Rating: 5**

Total Return
(last five years, indexed)



All chart data source: Bloomberg. Chart data to 2nd January 2019. For details of the Killik & Co risk rating system, please refer to page 9.

The yawing yield curve

Mateusz Malek

Head of Bonds Research

The potential inversion of the US yield curve has drawn quite a bit of comment from the media and the financial community recently. So, this quarter I offer a recap on how yield curves work and weigh up the factors behind this change in shape.

Nuts and bolts

The yield curve is created by plotting different maturity government bonds, such as US Treasuries, on a single chart, with the shortest-dated on the left and the longest-dated on the right. As investors would typically require greater compensation for holding a longer-dated security, the yield curve tends to be "upward sloping" – the longer-dated bonds offer higher yields than the shorter-dated ones. However, in the latter stage of the credit cycle, yield curves tend to "flatten", which means that these differentials are narrowing. For US Treasuries, this usually occurs when the Federal Reserve is raising rates, therefore increasing yields at the shorter-end of the yield curve.

Although there are many ways to measure the steepness of the curve, the most popular is the difference between 10-year and 2-year government bonds. At the time of writing, this "2-10yr spread" in the US stands at just 0.13 percentage points, the lowest since 2007 and well below the 2.90 level reached in 2009. Meanwhile, the 2-10yr spreads for the UK and Germany stand at 0.51 and 0.84 percentage points respectively.

Historically, the slope of the yield curve has often acted as a leading indicator of economic activity. This is because its overall shape reveals where investors think interest rates are heading. If investors expect interest rates to fall, a trend which is usually associated with a slowing economy and lower inflation, the yield curve will flatten and may eventually invert.

Interpreting inversion

Traditionally, an inverted yield curve has been seen as a warning of impending recession.

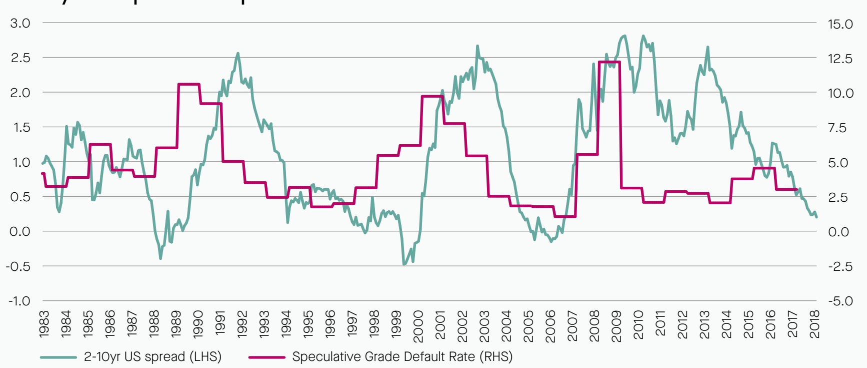
One explanation for this is that its shape is linked to the cyclical expansion and contraction of bank lending and the associated default cycles. When yield curves are steeply upward sloping, financial institutions may be more willing to lend money, as the difference between the short-term rates at which they borrow, and the longer-term rates at which they lend, renders the process more profitable. This helps to improve market liquidity, leading to a net loosening in lending standards and making it easier for companies to refinance their debts. That, in turn, reduces default risk.

However, as the yield curve flattens, potential gains start to look less compelling and lenders become slowly more selective about how, and to whom, they make loans. As lending standards tighten, the weakest corporates may eventually find themselves excluded from access to vital financing, leading to a rise in defaults. A glance at the last three major default cycles, which all coincided with recessions (in 1990-91, 2001-02 and 2008-09) shows that they all occurred after the inversion of the 2-10yr US yield curve (**chart below**).

Tin hat time?

Before running for cover, however, it is important to highlight that the amount of time between the curve inverting and the start of a subsequent recession has historically fluctuated significantly. There have even been instances where the gap has been over two years long. As such, it is plausible to think that a curve inversion on its own isn't enough of a recession marker – some other catalyst, or a negative event, may be needed. This could include: a sudden spike in the price of oil, an inflation surge, or unsustainable debt accumulation. Further, other factors could be distorting the value of the yield curve inversion as a warning signal this time around. These may include: the impact of central banks' unprecedented monetary policies (such as quantitative easing), or a falling share of bank lending in US credit markets. So, whilst I believe that investors should recognise that, at this point in the cycle, it may be prudent to take some risk off the table, they shouldn't be panicked by recent changes in the yield curve. ●

2-10 yr US Spread vs Speculative Grade Default Rate



Source: Bloomberg

Saving for small ones

Matthew Roche

Associate Investment Director

Saving has never been more important for today's younger generations, particularly when it comes to their eventual retirement. They will not enjoy the certainty afforded by defined benefit pension schemes. Meanwhile, the other financial challenges they face continue to mount, such as the cost of buying property, paying school fees, or clearing the average student debt of over £50,000 (IFS). Little wonder that my older clients often ask me about the best ways to set aside money for their children's and grandchildren's long-term future. This quarter, I want to take a quick look at one in particular – the Junior Self-Invested Personal Pension.

Back to basics

Despite the fact that children are non-tax payers, like a full adult SIPP, the junior version offers tax relief on contributions at the basic rate of 20% in 2018/19, provided the total contribution does not exceed £3,600. Only £2,880 needs to be paid in, with the remaining £720 coming from HMRC. Anyone can contribute, whether immediate family, wider family or even friends, provided the annual limit is not exceeded.

Once inside a Junior SIPP wrapper, contributions may be allocated to a wide range of asset classes, whether cash (not a great idea when it comes to beating inflation over the long-term), bonds, shares or funds. Wherever it is allocated, the money is free to grow without attracting income tax, or capital gains tax. It should be noted that were a pension pot of this type to grow to a point where it exceeds the 'Lifetime Allowance' (currently £1,030,000), there would be tax consequences. However, this is unlikely to cause many Junior SIPP holders a problem over anything other than the very long-term.

Under the existing rules, a child will be able to access their SIPP at 57, although we would expect this to move up over time. Pension freedoms introduced in the 2015/16 tax year then apply, meaning that a SIPP holder is broadly entitled to withdraw up to 25% of their fund tax-free, with the rest taxable at their marginal income tax rate.

Thinking long-term

Whether this lengthy lock-in period is attractive to parents and grandparents will depend on their perspective and aims. On the one hand, investing money into a product with such a long time horizon makes it much less likely that they will get to see the recipient enjoy the money that they have invested. So, if the aim is to fund a first car, or a house deposit, then a different product, such as a Junior ISA, will be a better bet.

However, many contributors will like the fact that a Junior SIPP protects any money paid in from being spent too soon. What's more, a long lock-in period ensures that the child gets the maximum potential benefit from compound growth over time, especially when it comes to equity investing. Whilst your capital may be at risk and past performance is no guarantee of future returns, the Barclays Equity Gilts Study 2017 reveals that historically, although the probability of losing money over one year is greater in equities than it is in either bonds or cash, over 20-year periods, the reverse is true (see **chart**). Why? Firstly, equities have demonstrated that they have offered higher average annual returns and secondly, if the stock market suffers a setback, 20 years should be a long enough period over which to expect to recoup your losses.

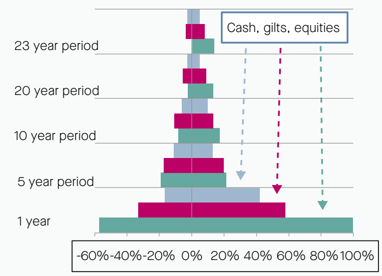
So, if you were to earn the Study's 1965-2015 50-year average annual UK stocks return of nearly 6% (before charges), just a single contribution of £3,600 could be worth close to £160,000, in today's money, after 65 years.

Under wraps

Deciding what to invest in when it comes to allocating Junior SIPP funds is very much down to the preferences of each investor. As a rule of thumb, I would caution anyone setting up one of these accounts against being too conservative – after all, if you can't take a bit of investment risk on behalf of a young child, when can you? Here are two funds that I personally favour.

Time really matters

Maximum and minimum real returns over various periods since 1899



Source: Barclays Equity Gilts Study 2015. Inflation is computed using a cost of living index based on inflation and then RPI data from the ONS

The first is Chelverton UK Equity Income. This smaller companies fund has a bias towards businesses that show 'value' characteristics. These may, for example, include companies trading on low earnings multiples and offering relatively high dividend yields. I like the focus on smaller companies, as these have historically done better than larger companies over time according to London Business School professors Elroy Dimson, Paul Marsh and Simon Staunton (CSFB Yearbook 2018). The opportunity to automatically reinvest the decent dividend yield of 4.4%, via accumulation units, is also attractive.

Another fund I like is Polar Capital Automation & Artificial Intelligence. The management team looks to identify businesses that are likely to benefit from the many disruptive and long-term changes taking place in the workplace. These encompass everything from industrial automation to the application of artificial intelligence across the professional services sectors.

Next steps

If you would like to discuss how a junior SIPP could help your children and grandchildren, or if you would like further information about the two funds mentioned in this article, please contact your Investment Manager or Wealth Planner.

Three defensive legal plays

Peter Bate

Portfolio Manager

In 1989, the year Paul Killik opened his first Chelsea branch, the legal services market was still being run on principles established centuries earlier and was dominated by private partnerships. Restrictions, that went beyond mere quirks of the structure of the industry, effectively ruled out an ownership stake in the sector for anyone other than lawyers. This comfortable situation, at least for those inside the profession's walls, was not demonstrably challenged until 2007. What followed changed the landscape for investors.

A smart Act

The Legal Services Act introduced the concept of the alternative business structure (ABS), which was a prerequisite for non-lawyers owning law firms. With the stage set for public listings, the first licences were subsequently issued in 2012. This infusion of capital into a once opaque sector was intended to drive investment in innovation and efficiency, with the end goal being decreased costs for clients.

Fast forward to today. Recent stock market volatility means we are facing an investment landscape that feels as uncertain as it has for some time. However, that makes a sector such as legal services attractive. This is in no small part down to its dynamics. Some areas within this huge and varied field undoubtedly show cyclical tendencies - examples include mergers and acquisitions (M&A) advisory work for companies and property conveyancing for retail homebuyers. Other important areas, however, are much more countercyclical. A good example would be the huge market for litigation, as a weakening economic and corporate backdrop exposes "bad" deals struck during easier times.

Within the legal services sector globally, the UK is the world's second largest market, with an aggregate valuation approaching £40bn. However, according to Business Research Company data from 2017, the listed sector remains relatively undeveloped, populated as it is by a handful of smaller company names. From an investor's point of view, therefore, it pays to be selective.

Serious sales from Keystone

Founded in 2002, Keystone recently made its way into the top 100 legal firms by revenue in the UK. This fast- growing, profitable and cash-generative challenger firm is now positioned towards the middle of the market.

Led by Founder and CEO James Knight, the management team was one of the first in the sector to adopt the "networked" law firm model. This enables self-employed lawyers to contract with the group via personal service companies, whilst continuing to work though their own offices. Lawyers at Keystone can therefore focus on practising law in their area of expertise, with all the related support services undertaken on their behalf. These include; lead generation and referral schemes; systems and IT, billing and compliance services. In return, Keystone charge around 25% of billings.

Whilst this might seem high, it is attractive to many types of lawyer. It may, for example, suit practitioners at traditional firms who are below partner level but nonetheless have a loyal, portable client base. The Keystone model can offer them an immediate and potentially significant, pay rise. It can also be a good option for those seeking a better work-life balance – for example, lawyers with young children who don't want to commute into a central office every day. Another winning feature is the simple fact that there are hundreds of other lawyers at Keystone, with expertise across a range of different types of law. This means that work is often referred across the group, with the lawyer who makes the referral receiving a healthy share of related billings. The effectiveness of this system is reflected in the fact that around 30% of all billings come from referrals from other Keystone lawyers.

Before setting our sights on this one, we took a hard look at some other law firms that have achieved relatively recent listings. However, we struggled with their cash flow profiles – they are hostage

to lengthy periods of work in progress management and some consequently large receivables balances. Keystone's lawyers, on the other hand, do not get paid until they have collected cash from their clients. This means that the biggest drain on the group - paying those same lawyers – can't take place until the firm has received funds in from the related billings. Keystone therefore has an edge as a cash generative business.

The firm came to market via an initial public offering (IPO), last year. Whilst it is hard to argue that the shares are very cheap on near-term earnings multiples, we nonetheless believe that Keystone could give consensus forecasts a run for their money. The underlying business model also has enduring long-term appeal for investors.

Pursuing growth at LCM

Our second firm in this space is Litigation Capital Management (LCM), an Australian-listed operation that is in the process of raising money and transferring its quote to the alternative investment market (AIM) in London. The main line of business for LCM is litigation funding. In summary, that is the process whereby a third party (in this case LCM) funds the legal costs of someone seeking litigation, with the aim of recovering them and taking a decent share of any award, made in the claimant's favour. From the claimant's point of view, this support enables them to defer the cost of litigation. In the case of a public company, for example, where such costs can have an immediate and material impact on profit and therefore valuation, not to mention cash flow, the benefit can be significant.

Critics may accuse LCM of funding what is sometimes labelled "ambulance chasing". However, we disagree, primarily because LCM is both a legal expert and, in effect, a fund manager. As such, it has little incentive to take on frivolous cases, or those without strong legal merit, as they are unlikely to be profitable in the long run. As evidence of this, investors may note that the group has funded just 32 cases since 2012, making an average return on invested capital of 1.38x, and only losing money on four of them.

The company was listed on the Australian Stock Exchange (ASX) until recently, with a market capitalisation of A$59m (£33.5m). We are poised to enter the story as part of a £20m fundraise (all new money) and a simultaneous transition to the AIM market. Moving the listing to the UK will bring it into a market where the whole sector is better understood, thanks in no small part to the incredible success of Burford Capital (the world's biggest provider of arbitration and litigation finance). Reflecting this move, LCM will move its business pipeline more towards Europe, following the recent hire of Nick Rowles-Davies. A pioneer for the litigation funding industry, he previously led the ex-Americas business for Burford and was a founder of sector peer Vannin Capital. His deep understanding of the UK market, and his contacts within it, should prove a boon.

The average case takes around 27 months to settle (a figure that can rise to 70 months or more in a handful of extreme cases), so we believe that it is not appropriate to value the company on a price to earnings basis, due to the high likelihood of cases either slipping, or being settled earlier than envisaged. For this reason, we believe that LCM should be viewed as more of a balance sheet proposition. Valuing the group on this basis is straightforward, as the management team employ cash accounting. This means they record the cash value invested in a case on the balance sheet, whilst only recognising any profit once that case is concluded along with the associated cash flows back to the company. The result is that ongoing projects are reflected at their true cost, free from subjective fair value adjustments and any booking of associated non-cash profits.

The shares are coming to market on 1.1x book value multiple (peer Burford trades on around 3x book by comparison). With a projected 2020 yield of around 3%, overall we see compelling value here, rooted in LCM's low equity market correlation and the countercyclical qualities of its business model.

Let's hear it for Bighand

At the time of writing, our final stock was due to float. However, we believe it succumbed to the wider malaise affecting equity markets in general, which has taken its toll on the IPO space. We hope that this will prove to be just a temporary setback.

Bighand is a provider of software to law firms, which helps them to delegate work to the appropriate member of staff. By using technology to improve pricing accuracy, legal services providers can also be more confident when it comes to offering the type of visible, fixed-price contracts that clients increasingly demand. The company enjoys high levels of recurring income, very strong margins and good cash generation, making it a name to keep an eye on. We are likely to support any IPO, subject to being comfortable with the valuation.

Key data

Name	Market cap (£'m)	P/E ratio	Yield (%)	Price	Currency	Risk rating
Keystone	111.3	27.8	2.1	356	GBp	9
LCM	77.1	8	3.6	71	GBp	9
Bighand	N/A	N/A	N/A	N/A	N/A	N/A

As at 2nd January 2019.
For more information about the Killik & Co Risk Rating system, please refer to page 9.
Please speak to your Investment Manager for further information.

No turning back

Svenja Keller

Head of Wealth Planning

This quarter, Svenja discusses the evolution of financial planning as the dust settles on a huge shake-up of the pensions landscape.

How has planning changed since you began your career?

I have seen a massive shift, right across the industry. In the past, a lot of financial advice was transaction-based and geared around selling certain products to win commission. There were clearly biases to recommend high-commission products.

Now, the whole focus is on the client – the starting point is working out what they want to achieve over a lifetime so that the right solution can be offered. We are much more relationship focused and try to offer people an all-encompassing (or "holistic") approach.

That shift has, in turn, fundamentally changed the skillset needed. Our priority is to work out someone's personal objectives and, because that takes time, we tend to deal with a much smaller number of clients with whom we hope to establish deep, long-lasting relationships. As a result, we must be comfortable with telling a client to do nothing if that is appropriate, something an "old-school" adviser would have found much harder to do.

The driver for much of this has been the sea-change in regulation (for example the 2012 Retail Distribution Review) alongside the fact that we want increasingly to be recognised as a profession, much like lawyers and accountants. The Personal Finance Society has taken great strides in that direction.

Does the EU still take a product-focused approach?

I come from Germany where much of the planning advice offered to customers is driven by the banks, wanting to sell their own products. There are simply not very many independent wealth advisers around to compete with them. By comparison, the UK is one of the most advanced global arenas from a regulatory perspective – a much more sophisticated system allows a plethora of firms of different sizes to offer unbiased client-oriented advice.

Should investment management and financial planning live under one roof?

Whilst specialising in one area or the other makes sense for individuals, in an increasingly complex world, I believe that clients need access to both skillsets to get a coherent and comprehensive solution. A Planner with limited investment experience can only solve half the equation and the same goes for an Investment Manager who is less well versed in, for example, complex pension rules.

Size therefore matters. On the one hand, whilst small, independent advisers find it very difficult to stay on top of both specialism, the huge wealth management houses can lose the close connection with, and deep understanding of, their clients that is so important. We are fortunate enough to be able to offer technical expertise across both areas whilst retaining a level of intimacy with our clients.

How do you see planning evolving?

Firstly, I would reiterate that financial planning advice will become ever more important in the context of investment management. I also think that technology is set to play an increasing role. I foresee advisers focusing more heavily on relationship management, with much of the associated technical work being undertaken by clever software and algorithms.

That said, human judgement is needed at every stage of the planning process to some degree. For example, sometimes the raw numbers in a spreadsheet point to a client taking a certain course of action but then you realise that they are not comfortable with it, perhaps because

of their family dynamic, or a host of other possible reasons. On other occasions, we see clients who have crunched the numbers and worked out that they are financially fine from a cashflow perspective but have failed to plan for a big tax charge further out because it is buried in the legislation. That's why quite a few of our discussions tend to start with the words, "have you thought about…?"

The problem is that no-one knows what they don't know, so an important part of our role is to help people avoid unpleasant surprises and sleepless nights.

If I were to sum up in three short phrases, what we will always need human advisers to offer, they would be;

Organisation – as our lives become more busy and complex, keeping on top of all of the detail can be both annoying and time-consuming

Advice – we can act as a critical friend and coach, working with people on their ambitions and priorities and helping to achieve them

Peace of mind – our clients want to know that they are being looked after and that they will avoid any major pitfalls.

What are the biggest recent changes we've seen in the pensions landscape?

2006's A-Day, or pension simplification, was perhaps the major one. It completely changed the way we see pensions – the personal pension became simpler and a lot more attractive.

Then, in 2015, pension freedoms arrived out of the blue and brought about a huge change in how people can access their retirement savings. Everyone now has much more flexibility about how and when they take benefits plus the ability to pass on pension assets tax-effectively to future generations.

The downside of change on this scale, is that some people are put off by the complexity and the risk of more changes in the future – our recent Pensions Freedoms report reveals some evidence of people trying to ignore the problem and not seeking help with navigating the retirement challenge.

Is the word retirement still relevant?

The demise of the final salary pension is undoubtedly having a huge impact on the way people view retirement, as much of the automatic security enjoyed by previous generations is slipping away. At the same time, a lot of the people we talk to don't want to face the "cliff edge" of stopping full time work and prefer to keep socially and mentally active, regardless of whether they need to plug a financial shortfall, or not.

Many people choose to work in a different field, perhaps fulfilling a life-long dream of working more creatively. Fortunately, changing work patterns are allowing people to be more flexible and work on in a part-time, or self-employed, capacity. Others may choose to make a fresh start and run their own business. These are decisions that we are often asked to help with. I see myself as kind of a critical friend for a lot of my clients, and I will not shy away from asking the more difficult questions. These include; whether they have thought about what they are going to do, how they will avoid isolating themselves if they don't have a large, or close, family and how they plan to stay mentally and physically active if they choose to fully retire.

When I ask clients how they expect their retirement to look, they often repeat the same clichés that everybody uses about having nice holidays and enjoying long sunsets. This makes me think that they may not have a realistic plan that will cater for the many hours in a week that used to be occupied by work and commuting. I see it as my role to help them build a clear, realistic and exciting picture of what their after-career life could look like.

What else should retirees be thinking about?

People don't like to contemplate what they will do when their health deteriorates, or what will happen when they die. These are difficult topics to consider but I believe it is important to have open and honest family discussions around them as early as possible. Research shows that these conversations can result in more wealth being available to be passed on to younger generations, thanks to greater tax efficiency.

However, in this context I also find that many people think too hard about who will inherit what they have when they are gone, before they think about looking after themselves. I quite often talk to clients who have saved for years and will clearly be comfortable in retirement – it's nice to be able to advise them to open the purse strings a bit and enjoy themselves!

A final point is that a lot of our clients underestimate increasing longevity – many have a good chance of living well into their 80s or 90s. Each additional year can make a difference to their financial plans, because living longer can bring unexpected health challenges. The sooner additional buffers are included in the financial plan for long-term care costs, the better and it pays to be realistic about the amounts involved.

What does our Pensions Freedoms Report reveal?

Pensions Freedoms continue to create plenty of challenges. There have been so many changes to the rules in relatively recent times that they inevitably create uncertainty and confusion.

The good news is that, despite the potential temptations, most people are being sensible. The Killik & Co Pensions Freedoms Report, which summarises research we have recently commissioned, highlights that, on average, people are withdrawing around 28% of their funds on reaching retirement age. Given that the first 25% is tax-free, that is reassuring.

More concerning is a widespread reluctance to seek advice – as an industry we must keep finding ways to overcome that. For example, a lot of clients have cited worries about what we call contingent charging, where a fee is only applied if a pension transfer is recommended and executed. We don't charge that way, because of the inbuilt incentive to move someone's money. My worry for those people who don't seek advice, perhaps because of poor past practice, is that they will miss out on planning opportunities and potentially pay more tax than they need to.

Another reason why people appear reluctant to take advice is the high number of scams prevalent in the market, particularly around pension wealth. This is something the regulator and our profession must continue to try to reduce, or better still, eliminate.

What should people seek advice about?

Two of the biggest areas are pension transfers and drawing down on the money they have accumulated. At first glance, both areas can seem straightforward, but there are so many little nuances in the legislation, especially on transfers. Although people may baulk at paying for advice here, if they don't they risk losing valuable guarantees, protections and even tax-free cash.

Equally, drawing benefits when the time comes sounds easy enough. However, it rapidly gets more complicated when the lifetime allowance ceiling is involved for clients with sizeable funds. Then there is the issue of tax-free cash – some of the older "protections" give higher entitlements that are easy to miss.

Despite a general reluctance to seek advice, I think the worst thing people can do is just stick their heads in the sand. It's up to us to continue to educate people about the benefits of engaging an Adviser and to be as transparent as possible about how we can help.

If you would like to find out more about our Pensions Freedoms Report, please speak to your Investment Manager or Wealth Planner.

Finding, developing and keeping talent

James Hornett

Human Resources Director

After his recent promotion onto Killik & Co's Executive Board, James Hornett explains how Human Resources (HR) will help to shape the future of the business.

Why HR?

My pivotal career moment came when I joined Killik & Co around 14 years ago. I was the most junior member of the team but that changed fast under the fantastic mentorship of Ali Dixon, the very experienced HR Director at the time.

I had previously left university, having studied business administration, without a clear vision of what I would do next. I first got the "HR bug" soon afterwards when I joined Royal Sun Alliance and realised that, even at a junior level, I really enjoyed talking to people and trying to understand their challenges. I then moved to a final salary pensions consultancy, where my role entailed helping actuaries to produce detailed valuation reports. Despite learning a huge amount, after five years I woke up one morning and thought "this just isn't me".

I knew by then that I wanted to get into mainstream HR and luckily for me, Killik & Co were recruiting. Thanks to Ali Dixon, I never looked back. Under her guidance I was exposed to every aspect of HR from early on. She pulled no punches – I learned fast how to address my own weaknesses and how to manage other peoples'. Along the way, I did various professional qualifications, including gaining membership of the Chartered Institute of Personnel and Development (CIPD). Whilst I have always cared deeply about developing people and helping them to maximise their skills and contribution, Ali really took me up the levels and made me realise how important HR can be in the context of the wider business strategy.

What are the key pillars of your role today?

At the highest level, I set the HR strategy. There are quite a few strands to this, spanning all aspects of recruitment, talent development and leaver management. I think the fact that I now sit on the Executive Board also reflects the importance to the business of having someone who can gather and articulate employee concerns and help to design the systems that can solve them.

What are your biggest challenges?

Diversity is a big one right across the financial services industry. Firms in this sector sometimes get a bad press for being what one female journalist recently described as, "male, pale and stale". We need to ensure that our client base at Killik & Co is reflected in our employee pool. Our challenge is to continuously educate potential joiners about what we do and the kinds of opportunities that are available – there is more to be done in this area by us and the wider industry.

Another big challenge, which our peers also face, is working out how to best motivate and retain staff. I believe that, in turn, is a function of how well we manage their career progression and all-round well-being, not just their remuneration. Everyone has different motivations and we need to make sure that our internal structures keep our employees engaged and happy, whether the solution revolves around benefits and career recognition, or working patterns and flexibility.

As part of this, we are constantly reviewing the tools available to line managers, and the training they receive, so that they feel confident to address any HR issues facing their teams.

Which parts of the job do you like best?

Speaking for the team, I would say it is the feeling we get at the end of a big recruitment campaign, knowing that we have brought some real talent to the firm. We are also rightly proud of the training regime that we subsequently put our Investment Managers and Wealth Planners through.

I also get a huge buzz from seeing people at all levels develop and become better professionals within the business. Compared to many of our peers, we don't have a high staff turnover and I think that speaks volumes. Infact, I would like us to shout about it a little louder sometimes. As a firm, we are also perceived as being a lot bigger than our employee base of around 230 would suggest – that reflects the fact that we nurture the calibre of employees we need to deliver a high-quality service and beat client expectations.

Has HR changed over the last 30 years?

A lot, yes. 30 years ago, many people viewed HR as a personnel department that hired people and then remunerated them. These days the whole function has moved on to become more of a strategic partner to the firm. Part of that role is properly understanding how valuable individual employees are and putting structures in place that satisfy their personal motivations, rather than simply ensuring that they get paid at the end of each month. We need to make sure our staff develop and remain passionate about the service they offer our clients. I spend a lot of time thinking about how we can ensure that the decisions taken at the top of the firm support this ethos and are properly communicated.

How has automation impacted your area?

In many positive ways. For example, it can take away some of the more mundane aspects of applicant tracking within recruitment, or sickness and holiday recording, without reducing the importance of a human touch when it comes to employee personal development.

The data now available to us can help here – if we see someone struggling, we have the tools, via our Wellness Hub, to start to identify why and try to find a solution. I am not just talking about physical health – mental well-being is now also an important part of our wider remit and we need to have the right people in place who can identify it and offer support, inside or outside the firm. The key point is that whether you are talking about absence, performance or pay, the metrics we can generate thanks to automation are very useful, provided the person explaining and interpreting them exercises the right judgement.

What are the biggest mistakes you see?

First, I don't believe in shying away from a difficult conversation. People deserve absolute honesty and transparency about their performance, good or bad. Constructive feedback isn't always easy to give but, delivered well, it commands a lot more mutual respect than burying tough issues. That's especially true in situations where a manager can help an individual to improve.

The other mistake people sometimes make is not bringing HR in early enough. Rather than being the heavy-handed approach some managers assume it is, the reality is that my team have the tools and systems to offer effective help fast. We don't see many difficult employee issues here and perhaps that reflects the fact that many of our managers already understand the importance of tackling potentially tricky situations early and involving HR. I am keen that all employees feel that they can talk to someone who will listen to them and then work on solving their problems. The recently introduced mentoring system is already helping in this regard.

Thirdly, I think firms must deal with leavers with dignity and respect – we try and make the experience as painless as possible, particularly when someone has worked for us for a long time and given a lot to the business. We are fortunate enough to have seen a number of our best leavers return to work for us over the years, so we must be doing something right.

How will your team support the wider business strategy in the future?

As we grow as a business, we need to be continuously looking at the organisational structure and analysing how teams are made up and setting up the appropriate levels of management structure. This encompasses both the front-line and operations functions. For example, we don't want our best client-relationship managers to be overburdened with administration and paperwork – we need the right systems and people to support them, from back to front office.

We are also working on ways to help our staff from a financial, as well as non-financial well-being perspective. If they want more support for themselves and their families around saving, planning and investing, then we must ensure that they have access to it.

Why will young, ambitious people want to join us 30 years from now?

For many of the same reasons they want to join now. First and foremost, we want to continue to provide great career opportunities. We must therefore protect our strong reputation, so that tomorrow's joiners look at us as a professional organisation that offers them the chance to develop. 30 years from now I'd also like to think we will face the same resulting challenge – stopping other organisations from poaching our staff. It's a nice problem to have in a way and I am sure it will continue to give us some sleepless nights! ●

Two corporate chameleons

Rachel Winter

Senior Investment Manager

Whilst a 100-year innings may be the norm for the next generation of people, the same cannot be said for companies. Credit Suisse observed, in a report last year, that the average lifespan of an S&P 500 member is now less than 20 years, down from 60 back in the 1950s. So, is it game over for the former corporate heavyweights?

Adapting to survive

The relentless march of the internet means that new companies can transition from start-up to global giant in just a few years. Incumbents are vanishing as the pace of change accelerates.

Yet, a surprising number of large businesses have weathered this onslaught and not just survived but thrived. Here are two big brands that have embraced change and altered their strategies to better suit the twenty-first century.

McDonalds – fighting the flab

Launched in California in 1940, McDonalds turned the drive-thru diner model on its head and pioneered the concept of fast food. The key objective of the two brothers who started the business was brutally simple – to serve high-quality food, quickly. As illustrated by critically acclaimed film 'The Founder', businessman Ray Kroc then introduced the franchise concept and took the company global. Now, the "golden arches" are widely recognized all over the world.

However, on the back of such rapid expansion the quality of McDonalds's offerings started to fade as Kroc prioritised profit margins over quality. In 2004, the brand suffered some huge reputational blows following the release of documentary 'Super-Size Me'. Morgan Spurlock tried to subsist only on the firm's food and publicised the adverse effects. A few years later, as the S&P 500 surged following the financial crisis, the McDonald's share price flat-lined from 2011-2015, as the world became increasingly focused on healthy eating. For a time, it looked as though Ronald McDonald's trademark grin might be set to turn into a grimace. But the brand has since implemented some major changes that have seen it return to growth.

In a bid to combat a reputation for serving little better than calorie-laden junk food, salads, porridge and fruit are now part of the menu. Full nutritional information is now also published for all products and the infamous 'super-size' option has been eliminated. An array of hot drinks and snacks even allows McDonald's to compete head-on with coffee shops.

Elsewhere, a drive to improve its ethical standing has spurred a new advertising campaign boasting of sustainably sourced ingredients. The company has even committed to stop using eggs from battery hens by 2025, a sizeable commitment considering that it uses 4% of US production. It has also embraced vegetarianism by launching meat-free restaurants.

Finally, McDonalds has turned to a combination of technology and transport – touch screen ordering allows the firm to serve more customers in its stores, whilst home deliveries mean it can reach a wider range of customers. As a result, the company has just celebrated a run of 13 consecutive quarters of same-store revenue growth.

Walmart – mixing it up

Launched in the 1960s, Walmart built massive out-of-town stores that lured shoppers with low prices. Indeed, it rapidly became the champion for the "stack them high, sell them cheap" principle that was to revolutionise the retail sector. The model worked – buying in bulk allowed it to undercut the competition and honour its pledge to customers to save them money. As a result, the company annihilated much of the high street and now employs 1% of the American working population.

More recently, however, analysts started asking how a company that relies on such a vast physical presence can compete in the age of online shopping. These doubts were reflected in its performance – between 2012 and 2017 Walmart shares did virtually nothing, as the Amazon share price quadrupled.

Now there is an answer – the omnichannel approach. Customers want to be able to move seamlessly between online and offline shopping by, for example, ordering online and collecting in store. So, ironically, whilst Amazon is building physical stores, Walmart is busy embracing the internet.

These days, the firm can offer customers online shopping, click and collect, one-hour grocery delivery, and mobile check-out in store. Numerous 'urban pick-up centres' have been installed to ease online order collection. Huge investment in technology has also streamlined the inventory management process, freeing up staff from menial tasks so that they can spend time promoting sales on the shop floor. As a result, this year the company hit $500bn in revenue for the first time.

Walmart's drive to adopt technology continues. The company has partnered with Google to implement voice shopping, and with Ford to trial driverless deliveries. Perhaps its boldest move has been the $16bn acquisition of Flipkart, India's biggest online retailer. This deal is the largest foreign investment that has ever been made in the country. Flipkart has historically sold consumer durables and clothing, but Walmart wants to break into the local grocery market. Given that India's population is currently quadruple that of America's, the retail opportunity is massive and on recent form, who'd bet against them?

Please note that the views expressed in this article are those of the author.

Uncertainty is the only certainty

Matthew Lynn

Columnist and Author

A knife-edge Parliamentary vote. The constant threat of a change of Prime Minister, a general election, a second referendum, or even multiple referenda until every possible permutation of Canada-Plus or Norway-Minus has been scrutinised and voted on. What a mess. Without a resolution of an issue – our relationship with Europe – that has haunted the UK for half a century now, our age-old political system could be under threat. Meanwhile businesses are crying out for some certainty so that they can start planning for a post-Brexit future. History suggests that they are likely to be disappointed.

A 50-year crisis

By this point in 2019, most investors probably hoped that the UK would have resolved the terms of its departure from the European Union so that businesses and markets could get on with life. Instead, we have a political stalemate that shows little sign of ending. When the 50th anniversary of our joining, what was then the Common Market, rolls around in 2023, it looks as though we will be a transitional EU member, still probably disagreeing over the Irish backstop, labour laws, fishing rights, City "equivalence" and any number of other issues. Surprised? You shouldn't be.

Plus ça change

Our involvement with the European Union has never been straightforward. Our first attempt to join was vetoed by the French. Then in January 1973, the Conservative Prime Minister Edward Heath finally took us into the Common Market, but on terms that were so disadvantageous that, no sooner had he signed the papers, than a furious campaign to reverse his decision began. His successor, Labour's Harold Wilson, felt compelled to re-negotiate and then held a referendum in 1975. The Remainers won that one. It didn't end there of course.

As the Common Market morphed into the European Union, Margaret Thatcher turned increasingly hostile and

eventually created such a rift within her party that she was removed from office. After John Major took over in 1990, our membership of the Exchange Rate Mechanism (which tied the pound to the euro) briefly wreaked economic chaos and forced our withdrawal in 1992. Meanwhile, a fearsome debate on the economic and monetary union proposed by the Maastricht Treaty, split the party following Major's pledge to put Britain "at the heart of Europe".

A degree of political calm on the issue then ensued under Tony Blair's New Labour party, as both he and Gordon Brown worked furiously to sell the European vision to the British people. A period of relative economic prosperity helped, supported in no small part by a massive net migration of cheap labour to the UK. But even they couldn't quell regular arguments about whether we should join the euro and in the meantime the Conservative Party was turning increasingly Eurosceptic. When David Cameron took over in 2010, he attempted, but failed, to renegotiate our EU membership. That set the scene for the 2016 referendum.

Will we stay, or will we go?

The truth is that, for other than fairly short spells, our relationship with Europe has been a constantly destabilising force in British politics. Today, the only parties with declared, settled positions on it are the Liberal Democrats and UKIP. The Conservatives are split roughly 60/40, if the December leadership vote is any guide, and Jeremy Corbyn's failure to land more political blows on the subject reflects a lack of confidence in his stance on the issue across the Labour Party.

Much to the frustration of our EU peers, there has never been a UK consensus around signing up for full-blown integration with continental Europe. Even membership of the single market, with its requirement that we permit the free movement of labour, was always going to be a challenge for an economy that is structured very differently to other EU members. Equally, there has never been an unequivocal consensus around leaving (as the 52/48 2016 referendum result proved). In short, a minimum level of ambiguity is baked in.

The never ending story

What businesses want more than anything now is clarity. I doubt they will get it. The UK can't fully detach itself completely from Europe and just adopt, say, WTO rules as our existing trade flows, work patterns and family and business ties with Europe are too entrenched and complex. The law of "economic gravity", as one economist calls it, makes us different to say the US or Japan. Size and proximity are what ultimately determines a country's relative global importance (or "gravitational pull") meaning that we should naturally seek a close, bilateral arrangement with our closest neighbour.

However, that's where the gravity argument stops. It is not realistic to imagine that the UK will ever, by extension, also be at the "heart" of what is an unfinished political project to forge nothing less than a European state. That might work for the likes of Germany, France and Spain, even if recent events in Italy suggest much convincing remains to be done, but it won't work for us. So, whilst on the one hand Tony Blair's determination to take us into the heart of Europe was misguided, so is the hard-core Brexiteers' headline-grabbing intransigence on cutting all ties with Brussels. Little surprise that time is running out for Theresa May (or whoever replaces her) to deliver the only thing she, or anyone else, probably ever could – a Brexit fudge.

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Here’s to the next 30 years

We are delighted to have once again been voted Best Discretionary/ Advisory Wealth Manager and Best Full SIPP Provider by the Financial Times and Investors Chronicle Awards 2018.

We could not achieve these accolades without you, our Clients.

As we celebrate our 30th anniversary this Spring, we extend our sincere gratitude for your continued support and thank you for being a part of our journey.

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